D.T.E. 99-23

Petition by Bay State Gas Company for approvals related to its Agawam electric production facility pursuant to G.L. c. 164, § 17A and 15 U.S.C.A § 79z-5(c), and waiver from the provisions of 220 C.M.R. §§ 12.00 et. seq.

APPEARANCES: Scott J. Mueller, Esq.

LeBoeuf, Lamb, Greene & MacRae, LLP

260 Franklin Street

Boston, Massachusetts 02110-3173

FOR: BAY STATE GAS COMPANY

Petitioner

I. INTRODUCTION

On February 18, 1999, Bay State Gas Company ("Bay State" or "Company") filed with the Department of Telecommunications and Energy ("Department"), pursuant to G.L. c. 164, § 17A, a request for approval of an investment of $1,000 in Bay State GPE, Inc. ("GPE"). GPE is a single-purpose subsidiary created to hold Bay State's interest in its Agawam electric production facility ("Facility"),[(1)] and to sell the output of the Facility in

the competitive wholesale power market. Bay State also requests that the Department make the requisite findings for the Facility to be deemed an eligible facility under the Public Utility Holding Company Act of 1935 ("PUHCA") pursuant to 15 U.S.C.A. § 79z-5a(c). In addition, the Company requests that the Department grant a waiver from two provisions of the Standards of Conduct, 220 C.M.R. §§ 12.00 et. seq.

The petition was docketed as D.T.E. 99-23. Pursuant to notice duly issued, the Department conducted a hearing on the Company's application on March 23, 1999, at the Department's offices in Boston. No petitions to intervene were filed. The evidentiary record consists of three Company exhibits and seven Department exhibits.[(2)] Together with the Petition, Bay State submitted a Memorandum in support of its requests.

II. COMPANY'S REQUEST FOR INVESTMENT

A. Company's Position

In 1989, according to Bay State, the gas-fired engine portion of the Facility was certified as a cogeneration qualifying facility ("QF") under 18 C.F.R. § 292.203(b)(1), and the turbo expander portion qualified as a small power production facility under 18 C.F.R. § 292.203(a) (Exh. BSG-1, at 8). The Company contends that under PURPA and FERC's rules, an electric utility may not own, directly or indirectly, more than 50 percent of a QF (Petition at 4, citing 18 C.F.R. § 292.206(b)). On November 5, 1998, the Department approved the acquisition of Bay State by Northern Indiana Public Service Company Industries, Inc. ("NIPSCO Industries"), NIPSCO - Bay State Acquisition, D.T.E. 98-31 (1998) (Exh. BSG-1, at 13). NIPSCO Industries is an energy and utilities holding company whose principal operating subsidiary is Northern Indiana Public Service Company ("Northern Indiana"), a combination utility serving gas and electric customers in Northern Indiana (Petition at 4). Since Northern Indiana serves electric customers, Bay State asserts that, under PURPA, it could not own or operate the Facility as a QF following its acquisition by NIPSCO Industries (id.). Therefore, Bay State shut down the Facility on January 6, 1999 (id. at 5). In order to operate the Facility after the merger, Bay State explains, it has to convert the Facility to an Exempt Wholesale Generator ("EWG"), and transfer the Facility to a subsidiary, because an EWG must be engaged "exclusively" in the ownership and/or operation of eligible generation facilities for the sale of electric energy at wholesale (Exh. BSG-1, at 14, citing 15 U.S.C. § 79z-5a(a)(1)).

Accordingly, Bay State now requests Department authorization to invest its funds in the amount of $1,000 in the wholly-owned, special-purpose subsidiary, GPE (Petition at 1). The Company asserts that it established GPE for the sole purpose of owning the Facility, and selling the output into the competitive wholesale market (Exh. BSG-1, at 15). The Company states that it will transfer the Facility to GPE as a capital contribution and enter into an Operation and Maintenance Agreement ("O&M") with GPE by which Bay State will continue to manage the generating units for GPE (id.).

Bay State asserts that its $1,000 investment will be used to purchase all of the 1,000 authorized shares of GPE Common Stock at $1.00 par value (Exh. DTE-5). According to the Company, the investment of $1,000 in GPE provides the nominal amount of working capital to cover initial expenses associated with operating the special purpose corporation (id.). Bay State asserts that this minimal investment is consistent with the Company's plans for GPE's activities to be limited to holding the ownership of the electric production facilities (id.).

According to the Company, the Department's jurisdiction over Bay State would remain unchanged as a result of this transaction (Exh. DTE-6). Bay State notes that, at the time of the Company's last general rate case, D.P.U. 92-111 (1992), $447,933 in costs and $506,002 in revenues from the Facility, representing a net gain of $58,069, were accounted for above-the-line and therefore included in base rates for the first time (Exh. DTE-2). Bay State contends that in NIPSCO - Bay State Acquisition, at 16-17, the Company agreed to freeze its rates for five years. Therefore, according to Bay State, the costs and revenues from the Facility included in D.P.U. 92-111 will remain in base rates through the rate freeze period (Exh. DTE-3). According to Bay State, if the Company files for a rate adjustment after the five year rate freeze, it will then have the burden of demonstrating the continued validity of including the Facility in base rates (id.). Therefore, the Company states that the Facility will be subject to review by the Department in future rate cases (Exh. DTE-7).

B. Standard of Review

Pursuant to G.L. c. 164, § 17A, a gas or electric company must obtain written Department approval in order to "loan its funds to, guarantee or endorse the indebtedness of, or invest its funds in the stock, bonds, certificates of participation or other securities of, any corporation, association or trust . . . ." The Department has indicated that such proposals must be "consistent with the public interest;" that is, a Section 17A proposal will be approved if the public interest is at least as well served by approval of the proposal as by its denial. Bay State Gas Company, D.P.U. 91-165, at 7 (1992); see Boston Edison Company, D.P.U. 850 (1983).

The Department has stated that it will interpret the facts of each Section 17A case on its own merits to make a determination that the proposal is consistent with the public interest. D.P.U. 91-165, at 7. The Department will base our determination on the totality of what can be achieved rather than a determination of any single gain that could be derived from the proposed transactions. Id.; see D.P.U. 850, at 7. The Department also found that the consistency standard best accommodates the Department's interest in protecting the utility's ratepayers from the adverse effects of unwarranted Section 17A transactions and a utility's interest in having flexibility in a changing marketplace to meet long term objectives of its ratepayers and shareholders. D.P.U. 91-165, at 7; Boston Edison Company, D.P.U. 97-17, at 6 (1997).

Thus, the Department's analysis must consider the overall anticipated effect on ratepayers of the potential harms and benefits of the proposal. D.P.U. 91-165, at 8. The effect on

ratepayers may include consideration of a number of factors, including, but not limited to: the nature and complexity of the proposal; the relationship of the parties involved in the underlying transaction; the use of funds associated with the proposal; the risks and uncertainties associated with the proposal; the extent of regulatory oversight on the parties involved in the underlying transaction; and the existence of safeguards to ensure the financial stability of the utility. Id. C. Analysis and Findings

The record in this proceeding demonstrates that the amount of funds requested is nominal and will be used to handle the necessary administrative expenses for the Facility. The Department agrees with the Company that there seems to be little risk and uncertainty associated with this investment. Indeed the costs and revenues of the Facility were reviewed by the Department in D.P.U. 92-111, and will be reviewable whenever the Company petitions the Department for a change in rates. Thus, regulatory oversight of costs and benefits to the Company's ratepayers will continue, and the Department will be able to ensure that ratepayers will not have to pay for Facility costs in excess of Facility revenues. Accordingly, after weighing the overall potential harms and benefits of the proposed equity investment, the Department finds that the investment of $1,000 in GPE, taken as a whole, is consistent with the public interest.

III. EXEMPTION FROM REQUIREMENTS OF STANDARDS OF CONDUCT

The Company has requested exemptions from 220 C.M.R. §§ 12.03(15) and 12.04(1).

A. 12.03(15) Exemption

Section 12.03(15) states that

> [e]mployees of a Distribution Company shall not be shared with a Competitive Energy Affiliate, and shall be physically separated from those of the Competitive Energy Affiliate. The Distribution Company shall fully and transparently allocate costs for any shared facilities or general and administrative support services provided to any Competitive Affiliate.

The Department may approve an exemption from the separation requirements of Section 12.03(15) upon a showing by the Company that shared employees or facilities: (1) would be in the best interest of ratepayers; (2) would have a minimal anti-competitive effect; and (3) the costs can be fully and accurately allocated between the distribution company and the competitive affiliate. 220 C.M.R. § 12.03(17). Such an exemption is valid until such time as the Department determines that modifications or removal of the exemption is necessary. Id.

1. Company's Position

Bay State seeks exemption from 12.03(15) so that it may continue to use its personnel to operate and maintain the Facility (Petition at 7). The Company contends that the Facility is "embedded" within Bay State's Agawam gate station that provides natural gas to the majority of customers within the 16 cities and towns served by the Company in western Massachusetts (Exh. DTE-1). Bay State contends that the Facility reduces the pressure of incoming gas and is integral to its pressure control and delivery system in Agawam (id.). The Company explains that the Facility must operate in concert with other Bay State equipment (id.). The Facility, according to Bay State, is essential to the safe, reliable supply of natural gas, producing electric power only as a by-product (id.). In light of this, Bay State argues that sharing of employees is necessary because the Facility is an integral part of the Company's gas distribution system; therefore, Bay State could not transfer control of the Facility to a third party, because to do so would create unacceptable risk to the reliability of the Company's distribution system and quality of service to its customers (Exh. DTE-4).

Bay State also contends that the Facility serves the dual purpose of regulating pressures and producing electricity, the full value of which would not be reflected in a purchase by a third party (id.). Because customers' rates are frozen for five years pursuant to the rate plan approved in D.T.E. 98-31, the Company asserts that a sale of the Facility to a third party in 1999 would result in no adjustment to customers' rates (id.).

Bay State asserts that GPE, through Bay State, will sell the output of the Facility into the new NEPOOL/ISO power markets (Exh. BSG-1, at 15). Bay State states that it will provide gas supply for the operation of the Facility under its G-52 sales service tariff and applicable cost of gas adjustment clause (id. at 16).

Bay State maintains that it does not intend to expand the activities of GPE in the wholesale electric markets, but intends GPE's participation in such markets to be limited to the sales made from the Facility (Exh. DTE-6). According to the Company, assignment of costs associated with services rendered will continue to be subject to Department review, as the transaction will be with a competitive affiliate (Memorandum at 8). For these reasons, Bay State contends that the sharing of employees is in the best interest of ratepayers (id. at 7).

Lastly, Bay State explains that the costs and revenues associated with the Facility have been booked above-the-line since the Facility went into operation, allowing the benefits

from the operation of the Facility to flow to customers for ratemaking purposes (Exh. BSG-1, at 13). The Company explains that in any base rate proceeding, review, or change of Bay State's rates, all costs and revenues associated with GPE will be included within Bay State's rate base and cost of service, including the payments resulting from the Bay State/Unitil Termination Agreement, subject to Department review (Petition at 5).[(3)] For these reasons, the Company states that it satisfies the requirements for waiver of 220 C.M.R. § 12.03(15), and accordingly, requests such a finding by the Department (Petition at 7).

2. Analysis and Findings

The Department finds that, with respect to the first condition, it is in the best interest of ratepayers for Bay State to maintain control of the Facility through the sharing of employees, to ensure the safety and integrity of the local distribution system. Regarding the second condition, the Department finds that the sharing of employees with GPE will not have an anti-competitive effect because the production and sale of electricity to the wholesale market should increase competition in that market and Bay State will have no monopoly-derived advantage in the electricity wholesale market. With respect to the third condition stipulated in 220 C.M.R. § 12.03(17), the Department concludes that, in essence, nothing will change in the Company's identification and assignment of costs and revenues as a result of this transfer. The assignment of costs associated with services rendered on behalf of GPE will continue to be subject to Department review under 220 C.M.R. § 12.04(2), because the sharing of employees will constitute a transaction with a competitive affiliate. Based on the foregoing analysis, the Department finds that the Company has met its burden of proving that the sharing of Bay State's employees with GPE satisfies the three conditions set forth in 220 C.M.R. § 12.03(17), and accordingly, Bay State's request for exemption from 220 C.M.R. § 12.03(15) is approved.

B. 12.04(1) Exemption

Section 12.04(1), the "transfer rule," states

[a] Distribution Company may sell, lease, or otherwise transfer to an

Affiliate, including a Competitive Affiliate, an asset, the cost of which

has been reflected in the Distribution Company's rates for regulated

service, provided that the price charged the Affiliate is the higher of the

net book value or market value of the asset. The Department shall

determine the market value of any such asset sold, leased, or otherwise

transferred, based on the highest price that the asset could have reasonably

realized after an open and competitive sale.

The "transfer rule" seeks to ensure that transfers of assets that have been included in rate base should capture for the benefit of ratepayers any market value in excess of book value. Standards of Conduct, D.T.E. 97-96, at 18, 20 (1998). This rule reflects the fact that any risk associated with investment in those assets was "borne by the ratepayers under traditional cost-of-service ratemaking." Id. at 20.

1. Company's Position

Bay State intends to transfer the Facility to its GPE subsidiary as paid-in capital at Bay State's net book value at the time of the transfer (Exh. BSG-1, at 15). According to Bay State, the net book value of the Facility on December 31, 1998, was $1,450,000 (id.). Following Department approval, Bay State asserts that it will enter into an O&M which will permit the Company to service the Facility, and maintain the safety requirements and cogenerational efficiencies provided by the Facility (Memorandum at 9). This structure, according to the Company, is unlike those contemplated by the Department when it promulgated the Standards of Conduct (id.).

Bay State contends that all the wholesale electric sales made by GPE for power generated by the Facility will inure to the benefit of ratepayers (id.). Bay State also asserts that its proposed transfer avoids transaction costs associated with a market valuation (Exh. DTE-7). Because the benefits of the transfer are intended to flow to Bay State's customers, the Company states a waiver of § 12.04(1) is justified (Memorandum at 9).

2. Analysis and Findings

The purpose of the Standards of Conduct, in part, is to govern the relationships between distribution companies and their competitive affiliates in energy-related fields because of the inherent market power enjoyed by monopoly distribution companies, and because of the risk of cross-subsidization of the unregulated businesses by the captive customers of the regulated business. Standards of Conduct at 11. The standards of conduct were originally promulgated, in part, to ensure that "no market participant, or group of participants, is in a position to exert unfair or abusive market power in a new competitive industry structure." Standards of Conduct; D.P.U. 96-44, at 2 (1996); see Electric Industry Restructuring Notice of Inquiry/ Rulemaking, D.P.U. 96-100, at 12 (1996). Such a situation is not the case in this proceeding. GPE was created for the purpose of facilitating the transactions of the Facility solely on behalf of Bay State; GPE is not an affiliate that is operating for profit. Section § 12.04(1) was not intended too apply to such a relationship.

The Company has asserted, and the Department has agreed, that selling the Facility to a third party is not feasible because the Facility is an integral part of Bay State's Agawam gate station and used to regulate pressures necessary for the safe operation of that station. Because the Facility should not be under the ownership and operation of a third party, it follows that the Facility should not be offered to the market to determine valuation, and

the cost to conduct an administrative determination of market value likely would outweigh the benefits, particularly since economic benefits of the Facility will continue to flow to ratepayers. Accordingly, § 12.04(1) was not intended to pertain to the particular circumstances of this proceeding.

Although the Standards of Conduct do not explicitly assign Department authority to grant companies an exemption from § 12.04(1), the Department interprets that such authority is implicitly present in the regulations.[(4)]

Accordingly, the Department finds that the Company has met its burden of seeking an exemption from the requirements of 220 C.M.R. § 12.04(1), and, therefore, the request is approved.

IV. DESIGNATION OF AGAWAM GATE STATION AS ELIGIBLE FACILITY

A. Company's Position

Bay State asserts that it had two options for operation of the Facility after the Company's merger with NIPSCO Industries: (1) sale of the Facility to a third party; or (2) converting the Facility to an EWG (Exh. BSG-1, at 14). The Company states that it rejected the first option for previously-stated reasons (id.). Thus, Bay State was left with the second option and pursued converting the Facility to an EWG (id.). According to Bay State, operation of the Facility as an EWG will require transfer of the Facility to GPE, because an EWG must be engaged "exclusively" in the ownership and/or operation of eligible generation facilities for the sale of electric energy at wholesale (id., citing 15 U.S.C. § 79z-5a(a)(1)). Therefore, Bay State contends, the Company could not operate the Facility as either a QF or as an EWG following the acquisition of Bay State by NIPSCO Industries (Exh. BSG-1 at 14).

According to Bay State, certification of the Facility as an EWG would allow the Company to control the safety and operations of the Facility (Petition at 6). Bay State asserts that this would benefit retail gas ratepayers because of the integral role the Facility plays in the Company's natural gas distribution operations (id.). Accordingly, Bay State requests the Department make the requisite findings to certify the Facility as an eligible facility under PUHCA, pursuant to 15 U.S.C.A. § 79z-5(c) (id. at 1).

The Company states that, in order to certify the Facility as an EWG, the Department must find that such certification (1) will benefit ratepayers, (2) is in the public interest, and (3) does not violate state law (id. at 6). Accordingly, Bay State requests that the Department make the requisite findings to certify the electric production Facility as an eligible facility (id. at 1).

Bay State asserts that, should the Department not make the requisite findings for the Facility to be an eligible facility, then the Facility will be closed permanently and will have no value except for salvage (id. at 6). The Company states that ratepayers would be negatively affected by such a shut down because the cogenerational efficiencies provided

by the Facility would be lost and thus, ratepayers would receive no future benefits from the Facility (Exh. DTE-4; Petition at 6). Moreover, Bay State argues, the Facility has little salvage value and the Company would need to install additional regulators to replace the Facility (Exh. DTE-4). Accordingly, Bay State argues that a Department finding that the Facility is an eligible facility will benefit ratepayers (Petition at 6).

The Company states that increased competition in wholesale electric markets is encouraged by the rules and regulations of the Department (Petition at 7). The Company proposes that if the Facility remains operating through a Bay State subsidiary the benefits of (1) an additional wholesale competitor in the market, (2) the cogenerational efficiencies provided, and (3) Bay State's protection of the Facility's operation and safety, would continue (Memorandum at 6). Bay State concludes that because increased competition in wholesale markets is envisioned and encouraged by the amendments to G.L. c. 164, and because no part of the law prohibits indirect gas company ownership of an EWG, an eligible facility determination is in the public interest and does not violate state law (Petition at 7).

B. Analysis and Findings

The Department finds that the designation of the Facility as an eligible facility will benefit ratepayers because without Bay State's direct oversight and operation of this Facility, the safety and integrity of the distribution system could be compromised. Because it will benefit ratepayers, and the records does contain evidence that it will harm the public, the Department finds that it is in the public interest. Since competing wholesale generators will be an integral part of the competitive generation industry that the Restructuring Act was designed to enable, the Department finds that the designation of the requested Facility as an eligible facility does not violate state law, but rather, furthers the objectives of state law. See Cambridge Electric Light Company, D.T.E. 98-78/83, 14-15 (1998). Accordingly, for the above reasons, the Department approves the designation of the Facility as an eligible facility, as defined in PUHCA.

V. ORDER

Accordingly, after due notice and consideration, it is hereby

ORDERED: That the proposal of Bay State Gas Company to invest $1,000 in the equity of Bay State GPE, Inc. be and hereby is approved; and it is

FURTHER ORDERED: That the Department approves Bay State Gas Company's request for an exemption from any applicable restrictions within 220 C.M.R. § 12.03(15); and it is

FURTHER ORDERED: That the Department approves Bay State Gas Company's request for an exemption from any applicable restrictions within 220 C.M.R. § 12.04(1); and it is

FURTHER ORDERED: That the Agawam electric production facility is an eligible facility as defined in PUHCA.

By Order of the Department,

_____

Janet Gail Besser, Chair

_____

James Connelly, Commissioner

_____

W. Robert Keating, Commissioner

_____

Paul B. Vasington, Commissioner

_____

Eugene J. Sullivan, Jr., Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).

1. According to Bay State, the electric production facility includes a turbo expander, a cogeneration engine and other equipment and wires (Petition at 2).

2. The Department marks for identification and hereby admits into evidence: (1) Bay State's Description of Agawam Electric Facility and Proposed Transactions, Exh. BSG-1; (2) Bay State's Termination Agreement for Purchase Power Contracts between Bay State and Unitil Power Corp. ("Unitil"), Exh. BSG-2; (3) Amendment No. 2 to Purchased

Power Contract between Bay State and Unitil, Exh. BSG-3; and (4) Bay State's Responses to the Department's First Set of Information Requests as Exhs. DTE-1 through DTE-7.

3. Between 1989, when the Facility became operational, and January 6, 1999, all of the net electric output of the Facility was sold by Bay State to Unitil (Petition at 3). On December 21, 1998, Unitil agreed to a buy-out of the Bay State/Unitil Contract, under which Bay State receives $150,000 annually over a ten year period (id.).

4. The Massachusetts courts have upheld the right of an administrative agency to make such interpretation of its own regulations. "An agency's interpretation of its own regulation is entitled to 'substantial deference.'" Hurst v. State Ballot Law Commission, 428 Mass. 116, 120 (1998); see also Boston Police Superior Officers Fed'n v. Boston, 414 Mass. 458, 462 (1993). "An administrative agency's interpretation should be respected, as long as it is not arbitrary, capricious, or contrary to the law." Hurst at 120.